

Answers to Key Asset Protection Questions

By Robert J. Mintz

When I sit with clients to prepare or review their estate planning and asset protection goals a wide variety of questions and issues arise: What plan is most efficient? How are tax savings created? How do we protect against lawsuit and business risk? Although I have addressed many these topics in detail in previous columns (See <http://rjmintz.com/assetprotectionarticles.html> for more details), here are a few starter questions which often arise and which may open the door for further thought and discussion.

If I have a Will do I also need a Living Trust?

A Will is a very important part of a basic estate plan and accomplishes these key objectives;

The first task of your Will is to specify the people that you want to receive your property. Usually the issue is how to take care of your spouse and children. Do we leave property outright or in trust and how do we make sure that each beneficiary gets his or her proper share?

The Will also designates a legal guardian for your minor children. If your spouse doesn't survive you, who will take custody of the children and provide for their financial well-being?

Potential estate taxes may also be an important consideration. The current law exempts amounts up to \$3.5 million in 2009 but only \$1 million after 2010 (See <http://www.rjmintz.com/pdf/Article-MDNetGuideMarch2008-EstatePlanning.pdf> for details). Congress is likely to adopt a new and permanent exemption amount at some point and the tax provisions of your Will should be designed to minimize estate taxes at least until the law has been settled.

What a Will does not do for you is avoid a probate of your estate. A probate is a public and court supervised collection of your assets, payment of taxes and other creditors and then a distribution of the remaining amounts to your beneficiaries. In many states this can be a time consuming, expensive and inconvenient process. To avoid these problems, most estate planning lawyers recommend a Living Trust in addition to the basic Will. Property which has been transferred to the Living Trust, prior to death, is not subject to the probate process and passes smoothly and efficiently to the named survivors. All the same estate planning objectives of passing property, minimizing taxes and taking care of family can be accomplished with the Living Trust but the additional advantage of probate avoidance almost always makes this the preferred estate planning choice.

Do I lose any tax benefits if I put my home in a trust?

The popular tax benefits associated with home ownership are the mortgage interest deduction and the ability to avoid gain on sale (\$250,000 for an individual and \$500,000 for a married couple). We often transfer a home into a trust for estate planning purposes and asset protection. But if we want to keep the tax benefits we need to draw the trust as a “Grantor Trust” following certain rules set out in the Tax Code. Either a revocable trust or an irrevocable trust can qualify as a Grantor Trust but the proper rules must be followed to avoid any unintended tax consequences.

Are Retirement Plans good for asset protection?

Retirement plans can be great asset protection tools. Qualified Plans (usually Defined Benefit type plans and 401k’s with a non-owner employee) have unlimited protection from most lawsuits and creditors, regardless of the amount. Non-Qualified plans like IRA’s are protected under many state laws for “reasonable retirements needs” and in bankruptcy for up to \$1 million in contributions. Also, at the point that you take distributions from these plans, whatever you take is entitled to the same asset protection rules. That doesn’t necessarily mean that stuffing all spare savings into a retirement plan is a good overall strategy because the tax consequences should be considered as well. All distributions coming out of a retirement plan are taxed at ordinary income tax rates, currently as high as 36%. The favorable tax treatment of capital gains and dividends (subject to a maximum 15% tax) is lost when distributed from a retirement plan. Weigh the benefits of the current deduction and deferral against the potentially greater tax rates on distribution when considering any program of retirement plan contributions.

What is a Life Insurance Trust?

If you own a life insurance policy the proceeds are subject to tax in your estate. If the total value of your estate, including the policy proceeds exceeds the amount which is exempt from tax, then the balance is taxed at the applicable rate. With tax rates that may be as high as 55% in 2011, a \$1 million policy may only result in net proceeds to the beneficiary of \$450,000. To avoid this problem, a life insurance policy can be held in an Irrevocable Life Insurance Trust known as an ILIT. This type of trust can be drawn to own the policy, remove it from your estate, and provide a large non-taxed fund for your survivors. To obtain these benefits your ability to access and manage the policy will be substantially restricted but if tax savings are a concern then the ILIT may provide a worthwhile solution.

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